

Internal Revenue Service
memorandum

TL-N-4203-88

WHEARD CC:TL:TS

date: MAY 12 1988

to: Director, Office of Coordinated Examinations OP:EX

from: Director, Tax Litigation Division CC:TL

subject: Counting Rule For Husbands and Wives and Trusts Under Blanco

You requested advice on March 7, 1988 as to when a husband and wife will count as one shareholder for the purposes of the small S corporation exception to the provisions of TEFRA and how a trust should be counted.^{1/}

ISSUES

1. When the only shareholders are a husband and wife, who are issued separate K-1's, should they be counted as one shareholder when (a) they file a joint return; (b) they file separate returns; (c) they own their stock separately; (d) they own their stock as joint tenants; (e) they own stock as tenants by the entirety or tenants in common.

2. Whether ownership of stock by a trust will disqualify an otherwise small S corporation from the provisions of TEFRA.

CONCLUSION

1. In all the above circumstances a husband and wife and their estates will constitute one shareholder for the purpose of the small S corporation exception to the provisions of TEFRA both under Blanco Investments & Land, Ltd. v. Commissioner, 89 T.C. No. 82 (December 12, 1987) for the taxable years ending December 31, 1983 through October 31, 1986 and under the new regulations for later years.

2. If any stock is held by a trust the S corporation will not fall under the small S corporation exception and thus will be fully subject to the corporate level proceedings of TEFRA.

^{1/} A related question which you did not raise and which we do not address is the effect of a divorce or marriage on the counting rule discussed herein. We will address these issues in a forthcoming technical advice.

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DISCUSSION

In Blanco, supra, the Tax Court held that the small partnership exception from partnership level proceedings under TEFRA (I.R.C. § 6231(a)(1)) also applies to S corporations of one shareholder through the incorporating provision of I.R.C. § 6244 for taxable years ending December 31, 1983 through October 31, 1986. Section 6231(a)(1)(B)(i)(II) provides that for the purposes of the small partnership exception "a husband and wife (and their estates) shall be treated as one partner." This provision is unqualified and thus should apply to a husband and wife regardless of the manner in which they hold stock or file their returns. Since the small partnership exception carries over to one shareholder S corporations through section 6244 the counting rule for husbands and wives which is a part of the exception also carries over.

Although the Court in Blanco implied that, due to differences between partnerships and S corporations, not all aspects of the small partnership exception may carry over (i.e., the number 10), the counting rule for husbands and wives should carry over. This is because the same considerations apply to both partnerships and S corporations in counting husbands and wives as one shareholder.

Even if the counting rule under the small partnership exception does not apply, the same result occurs under the counting rules applicable to S corporations in general. I.R.C. § 1361(c)(1) [a non-TEFRA provision] provides that for the purposes of counting shareholders in an S corporation "a husband and wife (and their estates) shall be treated as one shareholder." Note that this language is identical to that provided in the small partnership exception. This position is also taken in the new regulations applicable to small S corporations for later years. Treas. Reg. § 301.6241-1T(c)(2)(ii).

TRUSTS

The small partnership exception does not apply to partnerships which have a partner who is not a "natural person (other than a nonresident alien) or an estate" I.R.C. §

6231(a)(1)(B)(i)(I). This provision carries over in its entirety to S corporations. Thus, any S corporation which has a trust as a shareholder is not subject to the small S corporation exception, regardless of the number of other shareholders.

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